

EXECUTIVE SECRETARIAT

ROUTING SLIP

TO:

		ACTION	INFO	DATE	INITIAL
1	DCI				fsl
2	DDCI				
3	EXDIR				
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9	Chm/NIC				
10	GC				
11	IG				
12	Compt				
13	D/OLL				
14	D/PAO				
15	VC/NIC				
16	NIO/ECON		X		
17	D/OGI		X		
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SUSPENSE		Date			

Remarks

Executive Secretary

10 Oct 85

Date

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THE WHITE HOUSE
WASHINGTON

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CABINET AFFAIRS STAFFING MEMORANDUM

Date: 10/9/85 Number: 317007CA Due By: *John A. ...*

Subject: Economic Policy Council Meeting -- October 10, 1985

3:00 P.M. -- Roosevelt Room

ALL CABINET MEMBERS	Action	FYI		Action	FYI
Vice President	<input checked="" type="checkbox"/>	<input type="checkbox"/>	CEA	<input checked="" type="checkbox"/>	<input type="checkbox"/>
State	<input checked="" type="checkbox"/>	<input type="checkbox"/>	CEQ	<input type="checkbox"/>	<input type="checkbox"/>
Treasury	<input checked="" type="checkbox"/>	<input type="checkbox"/>	OSTP	<input type="checkbox"/>	<input type="checkbox"/>
Defense	<input type="checkbox"/>	<input checked="" type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Justice	<input type="checkbox"/>	<input checked="" type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Interior	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Agriculture	<input checked="" type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Commerce	<input checked="" type="checkbox"/>	<input type="checkbox"/>	McFarlane	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Labor	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Svahn	<input checked="" type="checkbox"/>	<input type="checkbox"/>
HHS	<input type="checkbox"/>	<input type="checkbox"/>	Chew (For WH Staffing)	<input checked="" type="checkbox"/>	<input type="checkbox"/>
HUD	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Transportation	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Hicks	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Energy	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Chief of Staff	<input checked="" type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Education	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
OMB	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
CIA	<input type="checkbox"/>	<input checked="" type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
UN	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
USTR	<input checked="" type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
GSA	<input type="checkbox"/>	<input type="checkbox"/>	Executive Secretary for:		
EPA	<input type="checkbox"/>	<input type="checkbox"/>	DPC	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
NASA	<input type="checkbox"/>	<input type="checkbox"/>	EPC	<input type="checkbox"/>	<input type="checkbox"/>
OPM	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
VA	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
SBA	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>

REMARKS:

There will be an Economic Policy Council meeting on Thursday, October 10, at 3:00 P.M. in the Roosevelt Room.

The agenda and background paper are attached.

RETURN TO:

☒ Alfred H. Kingon
Cabinet Secretary
456-2823
(Ground Floor, West Wing)

☐ Don Clarey
☐ Rick Davis
☐ Ed Stucky

Associate Director

THE WHITE HOUSE

WASHINGTON

October 9, 1985

MEMORANDUM FOR THE ECONOMIC POLICY COUNCIL

FROM: EUGENE J. McALLISTER *EM*

SUBJECT: Agenda and Paper for the October 10 Meeting

The agenda and paper for the October 10 meeting of the Economic Policy Council are attached. The meeting is scheduled for 3:00 p.m. in the Roosevelt Room.

The single agenda item is a discussion of the farm credit situation. At its October 2 meeting, the Economic Policy Council asked the Working Group on Agricultural Credit to develop several options for an Administration position in preparation for Congressional testimony beginning October 16. A paper prepared by the Working Group outlining the issues and offering several options is attached.

Attachments

THE WHITE HOUSE

WASHINGTON

ECONOMIC POLICY COUNCIL

October 10, 1985

3:00 p.m.

Roosevelt Room

AGENDA

1. Farm Credit Situation

THE WHITE HOUSE

WASHINGTON

October 9, 1985

MEMORANDUM FOR THE ECONOMIC POLICY COUNCIL

FROM: Working Group on Agricultural Credit Policy

SUBJECT: Agricultural Credit

During the last 60 days, operating conditions for the Farm Credit System have continued to weaken. The system has completed internal audits on its Federal Land Bank operations which indicate probable chargeoffs will be in the \$4-6 billion range. This is in addition to anticipated chargeoffs of \$1-1/2 to \$2 billion for the Intermediate Credit Bank (PCAs). Price Waterhouse is in the process of conducting the system's first external audit and will provide a third quarter report October 22. The operating system is anticipating significant additional deterioration of its real estate lending portfolio to be reported by year end. The final liquidated losses will be substantially less.

Recent additional media attention concerning a GAO review has resulted in further widening of the spread on securities issued by the system. Between now and Thanksgiving, the system will rollover \$9-1/4 billion of debt. The Farm Credit System withdrew its 9-month issue for the September 23 sale for both technical and marketing difficulty reasons. The most significant real risk faced by the Farm Credit System in the short term is its capacity to make the substantial rollover of securities during the month of October. Forty percent of the system's securities are held by commercial bank interests.

There are indications that some erosion of the system's capital position is beginning to develop. Actions by several districts to reduce interest rates to borrowers has adversely impacted the overall earnings capacity of the system. A continuing "flight" of the Farm Credit System's best borrowers, particularly in its most troubled districts, will become a serious threat to their financial stability if it is not brought under control in the near term. Current system capital and surpluses now total approximately \$11 billion -- \$4.2 billion of this is reported to be liquid -- \$5.5 billion of this amount is in the form of B stock held by borrower members.

As a result of the mounting Congressional concern over the general agricultural credit environment, and specifically the perceived serious situation within the Farm Credit System, Congressional hearings on credit are scheduled to begin next week. The House Agriculture Committee will hold its initial hearing for substantive action beginning October 16. The full Senate Committee will hold its first hearing October 17. The House Banking Subcommittee will hold its first hearing October 23

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and it is currently expected that the Senate Banking Committee will schedule hearings in October also. Both the Senate and the House are expected to develop and move legislation dealing with the Farm Credit System before the close of the calendar year.

The Farm Credit Administration's Federal Board has directed its Governor to develop a Federal assistance package in the form of legislation and to work with the Congress and the Executive Branch to seek passage during the remaining months of 1985. At the National Director's Conference of the operating system, a special group was assigned a similar task in behalf of the operating system. Both groups are maintaining reasonably close liaison and are expected to submit similar proposals to Congress next week. While final action has not been completed by the Farm Credit System, it is expected that the proposals will contain the following principal features:

1. A significant reform of the Farm Credit Administration.
2. A commitment of the system's excess surplus down to a level which would permit continued viable operations. Estimates of the amount of these funds range up to a maximum of about \$3.6 billion.
3. A line of credit or some form of guarantee of a special issue of system securities. There seems to be a wide discrepancy between the operating system and the Farm Credit Administration in the amount envisioned as necessary in this category ranging from \$6 to \$12 billion.

In addition, it is expected that Congress will review the guaranteed loan authorizations of the Farmers Home Administration. Some additional adjustment in the budget levels in this category for operating loans is likely.

The Independent Bankers Association of America has recommended major Federal intervention in the form of an "Aggie Mae" with substantial allocation of Federal resources. The American Bankers Association has elected to take no position on a specific legislative course. They have indicated that, provided any action to assist Farm Credit System does not expand its operating authorities nor offer assistance in the form which could be similarly applied to commercial banks, i.e. interest rate buydown assistance, they would not anticipate seeking specific legislative assistance other than the Farmers Home Administration guaranteed program for their member banks.

Congressional leadership on a bipartisan basis continues to recognize the highly technical and complex nature of the farm issue. Congressional leadership has sought Executive Branch advice on a responsible and reasonable course of action. The Farm Credit System is similarly seeking to work with the

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Administration in developing its recommendations along a line which would be viewed as a reasonable and responsible course of action by the Executive Branch. It is expected that the operating system will indicate that it will be in a position of severe stress by early next spring and that an assistance package will be needed to prevent this by the close of the calendar year. As has been the case with the general farm legislation, it will be significantly more difficult to manage once certain members begin to politicize the issue and engage in a "bidding war."

OBJECTIVES OF FARM CREDIT ASSISTANCE OPTIONS

The Working Group on Agricultural Credit Policy has identified several objectives in pursuing the proper policy response to the farm credit system's difficulties. These objectives include:

1. Minimizing the costs to the Federal taxpayer. The consequences and costs of the Farm Credit System's bad assets can be divided among the system's creditors, the farmers who own the system, and the Federal Government. Minimizing the Federal exposure by necessity means requiring the system's creditors, the bondholders, and/or farmers to take a loss.
2. Avoid affecting the credit status, and borrowing costs, of other Federally sponsored agencies. Requiring creditors, the bondholders, to suffer a loss may affect the market's perception of the strength of the securities of other Federally sponsored agencies, e.g. FNMA and the Home Loan Banks. Significant increases in FNMA's borrowing costs may precipitate the need for Federal assistance to that agency; higher costs for Home Loan Banks adds pressures on the thrifts and S&Ls.
3. Ensuring the availability of a private source of credit for farmers. Without some private source of farm credit, the Federal Government will become the primary provider of agricultural credit. It is imperative that some private entity exist to provide credit for spring planting at reasonable rates. This objective is not intended to encourage undue forbearance.
4. Restructuring the Farm Credit Administration to ensure that the system manage its problems in the future. The current difficulties also provide an opportunity to enact dramatic reform of the system's structure management, and operation. At a minimum, these reforms must be included in any solution to the problem.

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These objectives can be in conflict. Minimizing Federal costs by requiring creditors to take a loss raises the problem of the market's perception of other Federally sponsored agencies. Having the Federal Government step in, without adversely affecting the creditors, may diminish Congressional enthusiasm or will for enacting the reforms necessary to assure the long term viability of the system.

OPTIONS

The Working Group agrees that in any discussions with Congress, the Administration must emphasize that at a minimum the FCA must be reorganized and the assets of the operating system pooled. The following restructuring proposals are common to the four options presented below:

1. Restructure the authorities and enforcement powers of the FCA to be similar to those powers provided the Office of the Comptroller of the Currency.
2. Restructure the FCA management to eliminate any apparent or real conflicts of interests.
3. Provide for the transfer of excess surplus from the Farm Credit operating system to its Capital Corporation in Denver.
4. Authorize the Capital Corporation in Denver to manage the orderly work-out of bad loans and give it the explicit authority to assess the earnings of operating entities to support debt service and losses.
5. Reassess the Farmers Home Administration's lending requirements based on an evaluation of current credit conditions and adjust the guaranteed lending authorities to reflect the probable level of Administration authorized activity for the commercial banks and short-term PCA lending activities in the 1986 agricultural lending season.
6. Statutorily prohibit new direct lending for farm operating loans under FmHA. Provide a phaseout of farm real estate loans by FmHA over the next three year. Incorporate authorities provided in the Senate version of the agricultural bill for management of non-performing loans in the FmHA portfolio.

With these provisions as a common element, the Working Group has developed three options. These options differ not only with regard to the weights placed on the four objectives but also in their strategies.

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Option 1: Continue the current Administration policy of expressing a belief that the system has the capacity to manage its own problems.

Advantage

- o Until we have reliable data and know the true condition of the FCS, action may be premature.

Disadvantage

- o This position appears to have been overtaken by market and congressional events.

Option 2: Support or propose legislation to reorganize the FCA; move excess surplus to the Denver corporation; and require a complete independent audit; while offering to continue to work with the Congress and the system to determine the system's needs and its abilities to manage its own problems.

Advantages

- o Gets around the FCS's institutional reluctance to pool its resources.
- o Adds \$3-5 billion in short-term liquidity to the FCS, lessening the threat of a system-wide default.

Disadvantages

- o May not satisfy Congressional concerns that the system is in serious difficulties. Congress may reject our approach, leaving the Administration out of the issue.
- o This action may not be enough to reassure the market, with spreads continuing to widen.

Option 3: Take a similar stance as option 2 for the short-term, but indicate a willingness to work with Congress to more actively support the FCS in the long term under appropriate conditions.

These conditions might include investigating the possibility of creditors' sharing costs; requiring repayment of any Federal assistance; and ensuring the availability of a private source of credit for farmers.

Advantages

- o The burden of the FCS's problems is shared among FCS shareholders and creditors and the Federal Government.

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- o Separates the interests of creditors and farmers. Creditors would be held responsible for their investments; farmers will be assisted through the new parallel lending entity.

Disadvantages

- o To the extent that creditors are expected to share in the cost of a bailout, the market for FCS bonds will dissipate.
- o Diminishing FCS's ability to market its debt may affect the market's assessment of other Federally sponsored credit agencies, e.g. FNMA and the Home Loan Banks.

Option 4: Take a similar stance as option 2 for the short term, and establish a line of credit from the Treasury to the FCS's Denver Capital Corporation, matching the FCS's contribution of excess surplus to the Capital Corporation. Any funds borrowed through the revolving fund at the Treasury would be subject to repayment at such terms and conditions as the Secretary of the Treasury may prescribe.

Advantages

- o Congress will view this proposal as a positive effort by the President to address the FCS's problems.
- o May be used as leverage to negotiate significant reductions in the cost of the Farm Bill.
- o Provides a means for the FmHA to withdraw from direct lending and to begin to effectively deal with its non-performing loans.

Disadvantages

- o Commits Federal funds of \$3-5 billion. May be viewed as a precedent for other troubled financial institutions, including FSLIC.
- o The sound operating units within the FCS may continue to successfully resist making their surplus funds available to troubled operations.
- o The commercial banking industry may expect that some of the FCS authorities and assistance would be extended to them as part of any agricultural credit package.